

January 6, 1992

Pensions & Investments

The Newspaper of Corporate and Institutional Investing

\$10 An Issue \$150 A Year

Investors to Bush: Hands off the economy

President urged to think of long-term incentives



President Bush should avoid the temptation to meddle with the economy, pension executives and money managers say.

By Curtis Vosti
and Terry Williams

President Bush need not take politically expedient election-year measures to jump start the economy, pension executives and money managers say. The Federal Reserve Board's latest interest rate cut will do the job, they add.

Any action the president takes to help the country dig out of the recession should be long term, such as incentives for saving and investment, according to the two dozen professionals interviewed by *Pensions & Investments*.

Still, many of those interviewed believe the November elections will force President Bush to act.

"I think it's inevitable in an election year that politicians from both parties will do everything possible to get the economy moving," said Richard Crowell, chief investment officer of PanAgora Asset Management, Boston. "The reason is incumbents want to be re-elected, which is easier to do when the economy is doing better.

The question isn't should he or shouldn't he. He will."

Roland Machold, director of the New Jersey Division of Investment, Trenton, said he fears the economy will become hostage to political agendas. "The Democrats have the individual retirement account, and the Republicans have the capital gains reduction," he said. "None of these things has anything to do with the economy. They are being advanced for the political agenda of the parties. What is needed is to encourage capital spending."

That's just what the Federal Reserve did when it lowered rates, according to Tom Cowhey, executive director for trust investments for Bell Atlantic Corp., Philadelphia. "The Federal Reserve has taken positive action to encourage investments. To get the economy going again, actions need to be done to encourage long-term investing that would not be inflationary," Mr. Cowhey said.

"I don't know what the president could do. The Federal Reserve is carrying the ball," said David Bronner, chief executive

officer of the Retirement Systems of Alabama, Montgomery.

But many expressed some fear that short-term measures, like the proposed one-year cuts in either the income or Social Security taxes, would not work as expected, and thus exacerbate an already huge budget deficit.

"I think he ought to wait a little while longer," said Neil T. Eigen, chief investment officer with Bear Sterns Asset Management, New York. He said he favors slow growth because it doesn't place pressure on interest rates or cause inflation. "What we are seeing is a lot of people getting nervous that the economy won't grow rapidly. Slow growth doesn't disturb me."

Mr. Eigen said he fears a quick-fix action such as a tax cut. "I would like to wait and see if lower interest rates work. Give it at least three more months," he said.

Robert Manning, vice president and chief economist for Axe Houghton Management Inc., Tarrytown, N.Y., said he doesn't think there's much President Bush, or Congress, can do. "As

See **Bush** on page 30

AT DEADLINE

Pension exec leaves Kodak

A. Duff Lewis Jr., pension investment coordinator at Eastman Kodak, has joined Rogers, Casey & Associates as a member of its alternate investment group. Mr. Lewis will be replaced by Robert D. Spooner, an 18-year Kodak veteran who had been a financial analyst for the company.

U.K. fund earnings up

Average 1991 returns of U.K. pension funds are expected to exceed 16%, according to initial estimates of The WM Co.

Total asset returns for 1991 are significantly above the inflation indicators of the Retail Price Index at 5% and the Average Earnings Index of 7%. The firm estimates a real return for British funds of more than 10%.

The top performing asset classes were overseas equities, returning an estimated 20.6%, and U.K. equities, 20.1%. U.K. property, with an estimated -0.2%, was the worst performer.

Manager retires

Kenneth L. Holmes, vice president and sales manager at Meridian Investment Co., has retired after a 37-year career in investment management.

Chase names global head

Mark Tennant, former chairman of Bell Laurie White & Co. Ltd., a subsidiary of Hill Samuel Investment Management Group, has been named head of Chase Manhattan Bank's new global securities service office in Edinburgh, Scotland.

Market rally sustainable, execs declare

By Barry B. Burr
and Fred Williams

The Federal Reserve-provoked decline in interest rates will continue to fuel the stock market rally — and create havoc for fixed-income investors.

Investors are buying dividend-attractive stocks and longer maturity bonds as low short-term interest rates force them out of cash.

The resulting stock market rally — the Dow Jones industrial average gained 258.27 points since the discount rate was slashed Dec.

20 — is sustainable, according to market watchers interviewed by *Pensions & Investments*.

Meantime, 1991 was "an absolute home run" for bond investors, said Aitha Duersten, senior vice president of Bank of New York, with returns above 14% for broad-market bond funds.

Analysts said the rallies in both stocks and bonds are being fueled by unusual, albeit man-made, factors. Among them:

- The Federal Reserve Board has cut the discount rate six consecutive times in the last 12 months, only the sixth time in its history it has made so many suc-

cessive reductions.

- The yield curve is so steep Treasury bond yields are more than double Treasury bill yields, a situation not seen since the 1950s, said Robert D. Arnott, chief investment officer, First Quadrant Corp., Pasadena, Calif. By another measure, the curve is so steep, T-bonds now yield more than four percentage points over T-bills. The typical difference is about 1½ points.

- About 35% of the stocks on the New York Stock Exchange yield more than T-bills, "a surprisingly high number," Mr. Arnott added.

For fixed-income investors, the prime problem now is that reinvestment rates are plummeting.

The reinvestment risk for many existing guaranteed investment contracts due to expire soon is "staggering," said Jason Psome, principal, Brentwood Asset Advisors, Santa Monica, Calif.

For example, GICs with three-year maturities still are 50 to 70 basis points over Treasuries, but, he said, "we are talking about some very low rates." A high-quality five-year contract is about 6.6%.

Reinvestment risk has heightened. See **Decline** on page 26

AT&T funds huge retiree health costs

By Hillary Durgin

BASKING RIDGE, N.J. — American Telephone & Telegraph Co. is spending \$550 million to begin to pre-fund its estimated \$5.5 billion to \$7.5 billion in post-retirement medical liabilities.

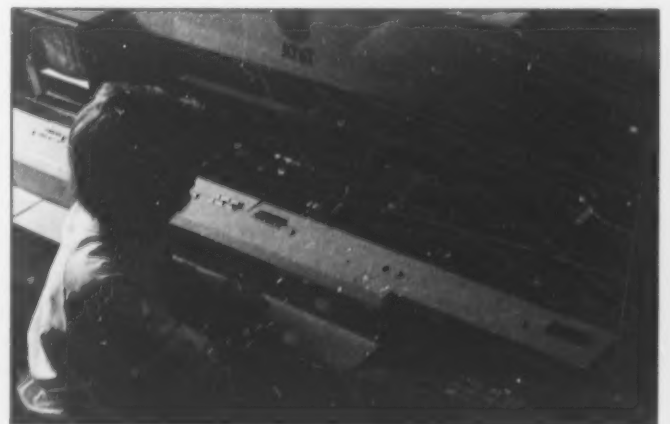
AT&T likely will set aside \$500 million annually over the next few years to offset the liability and pay post-retirement health expenses, now estimated between \$35,000 and \$40,000 per employee, said James A. Heller, in-

vestment director, AT&T Investment Management Organization.

The assets AT&T is setting aside to pre-fund are in addition to the \$500 million in retiree medical claims the company pays annually, Mr. Heller said.

"By the latter part of this decade we ought to have enough money in trust funds to completely defease the retiree liability," Mr. Heller said. "We're ahead of a lot of folks in that we are attempting to build trust funds for the purpose of offsetting part of

See **AT&T** on page 28



AT&T's post-retirement health obligations now are being pre-funded, with \$550 million set aside in 1991.

NEWS DIGEST



The Oregon Public Employees Retirement System's Jim George, reflecting on his 25-year tenure at the fund, says he enjoyed himself so much he "would have done it for free." Page 6.

SPECIAL REPORT: DEFINED CONTRIBUTION PLANS

Cash balance plans should get a boost from the publication of Internal Revenue Service regulations. Page 17.

Corning Glass Works is on the growing list of proponents of employee stock purchase programs. Page 17.

401(k) plan sponsors are faced with the pros and cons of bundled services. Page 17.

FINANCING

Investors found success in many places during 1991, especially with new issues. Page 2.

INTERNATIONAL

Overseas investments are seen growing 25% to 30% for at least the next four years. Page 3.

REAL ESTATE

Equitable Real Estate faces \$600 million in withdrawal requests. Page 2.

No recovery is forecast for office space demand, meaning property returns will remain weak. Page 3.

DEPARTMENTS

Classified	28	Hirings	25
Commentary	14	Opinion	12
Current accounts	22	Pension Surplus Index	10
Frontlines	8	P&I Indexes	8

Vol. 20, No. 1 — Pensions & Investments (ISSN 1050-4974) is published biweekly with a special edition in May by Crain Communications, Inc., 740 Rush St., Chicago, Ill. 60611-2590. Second class postage paid at Chicago, Ill. and at additional mailing offices. Postmaster: Send address changes to Pensions & Investments, Circulation Dept. 965 E. Jefferson, Detroit, Mich. 48207.

Investors score with IPOs

Buy-outs, high-yield bonds part of year's stellar deals

By Anne Schwimmer

Investments in new issues by small, but fast-growing, U.S. companies made superb home runs in 1991, institutional investors say.

Among the winners: **AutoZone Inc.**, **Royal Appliance Manufacturing Co.** and **Syquest Tech.**

"When the economy is performing, then everybody's getting pulled along," said Ray Hirsch, senior portfolio manager at IDS Financial Services, Minneapolis. "But when the economy is stagnating... you have to have something really different to extract more dollars out of a company that's stagnating. For a big company to have something like that is really difficult. But a small company that's starting up, if they can come up with a better mousetrap, people will beat a path to their door."

Many of these home runs sur-



faced in last year's wave of initial public offerings and secondary offerings by emerging growth companies.

In addition, investors cite the returns garnered by equity investments in leveraged buy-out partnerships and the strong rally in the high-yield bond market as

good investments of 1991.

(Some deals — such as Time Warner Inc.'s disastrous rights offering — were singled out as choices for the worst deal of the year. See related story page 27.)

According to David Shinn, managing director at CIGNA Investments Inc., Bloomfield, Conn., one of the most interesting — read profitable — deals of the year was the 3.25 million share IPO brought by AutoZone. AutoZone was bought out by Kohlberg Kravis Roberts & Co. in 1984. The IPO and a secondary offering sold 40.2% of the company to the public, with KKR retaining a 59.8% controlling stake in the auto parts retailer.

The company, which estimates sales of \$970 million for 1992, has a market capitalization of about \$2 billion, Mr. Shinn said.

"The most important reason from the perspective of a shareholder is that the stock has done extremely well," Mr. Shinn said.

See **Deals** on page 27

Minorities seek federal assets

Managers learning 'how to play game'

By Hillary Durgin

WASHINGTON — Spurred by their victories in gaining access to the hiring processes at state and local pension funds, minority- and woman-owned money management firms are targeting more than \$371 billion in federal assets.

While these young and mostly small firms face some of the same obstacles encountered at state funds, the peculiarities of investing federal assets — combined with the government's labyrinthine bureaucracy — make breaching the barriers doubly difficult.

Still, these managers want a crack at the federal pot, which includes the mammoth \$259 billion Civil Service Retirement System, the \$93.7 billion Department of Defense Military Retirement Fund, the \$10.6 billion Federal Retirement Thrift Investment Board, the \$4.2 billion Pension Benefit Guaranty Corp. and various non-appropriated defense funds with assets totaling \$3.8 billion.

"There are tremendous pools of money," said Maceo Sloan, chief investment officer at NCM Capital Management Group Inc., Durham, N.C. Mr. Sloan also is founder and chairman of the National Investment Managers Association.

"We all know there's got to be a lot there, but none of us is sure what it is or where it is," he said.

"It's just a matter of learning how to play the game."

Women and minority managers, however, are not only trying to learn the game but also, with the help of some members of Congress, trying to rewrite the rules.

Unlike other government agencies and their contractors, retirement and welfare funds overseen by federal agencies have no set-aside, quotas or goals. And while the minority investment management community is divided over whether such affirmative action initiatives are appropriate, what they want most of all is the chance to compete.

"We're not talking about favoritism or minority preference," said Marx L. Cazenave, president of Progress Investment Manage-

See **Federal** on page 29

Fund faces \$600 million drain

By Steve Hemmerick

Institutional investors, increasingly uneasy with a worsening outlook for real estate, are stand-

ing in line to withdraw more than \$600 million from the Equitable Prime Property fund, the nation's largest commingled real estate investment fund.

Officials of Equitable Real Es-

tate Investment Management, New York, deny the more than \$600 million in withdrawal requests is a record for the fund, but it is the largest publicly revealed amount for any fund. In fact, most commingled real estate funds have less than \$600 million in assets.

The Prime Property fund situation illustrates how pension fund investors and real estate money managers are being pulled in different directions. Some investors want to raise cash from real estate; others want to remain in the commingled funds; and money managers contend they need operating cash to fight for tenants and retail market share in fiercely competitive, overbuilt markets.

At the same time, say consultants and money managers, managers can't sell much property to raise cash to meet withdrawal requests because the bottom has dropped out of the real estate market.

Paul Saylor, a principal in the Atlanta office of the real estate consulting firm Institutional

See **Property** on page 31



Southdale Mall is one of the Prime Property holdings benefiting from Equitable Real Estate's mall enhancement program.

PEOPLE

Economist drawn to lights and smell of grease paint

■ By day a mild-mannered economist, Carolyn Kay Brancato by night is a playwright and director.

The executive director of Columbia University Law School's Institutional Investor Project recently wrote and directed "Clear and Present Danger," a one-hour production of readings celebrating the First Amendment.

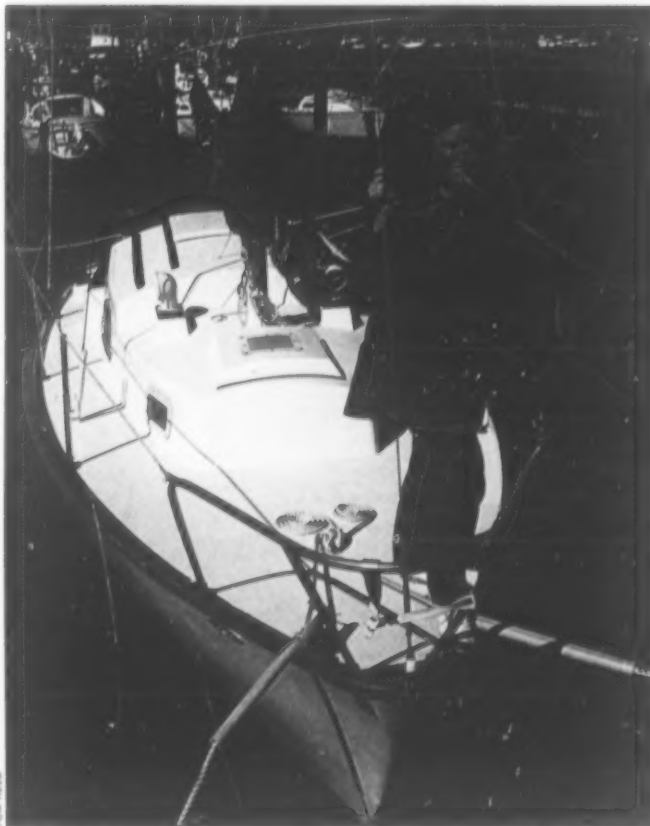
Presented as a benefit on behalf of the National Coalition Against Censorship, the theatrical event featured readings by such celebrities as Planned Parenthood President Faye Wattleton, young adults' author Judy Blume, Playboy Enterprises Chairman and Chief Executive Officer Christie Hefner, and actors Eli Wallach and Anne Jackson.

Also, introducing the performance and one of four co-chairs of the event was Ira Millstein, senior partner at the law firm of Weil, Gotshal & Manges and chairman of the Institutional Investor Project.

But the work won't stop there. Stemming from the New York production, Ms. Brancato will serve as artistic director of a new Washington-based non-profit theater group focusing on political and social issues.

Her next project: Producing another play she wrote that chronicles the turn-of-the-century arrest of a Russian traveling circus in Germany for mocking Kaiser Wilhelm. The circus' offense, based on a true story, was to train its pigs to mimic the royal family.

—Joel Chernoff



When she's not watching economic indicators, Carolyn Kay Brancato is a playwright and director.

INTERNATIONAL

Funds expected to boost holdings

■ Two-thirds of the fund executives responding to a recent survey by SEI Capital Resources said they expect to increase their international holdings this year.

In addition, 82% of the respondents said international investing should become more attractive.

SEI, Wayne, Pa., surveyed more than 200 executives of corporate,

public and Taft-Hartley pension, endowment and foundation funds at a recent seminar on international investing. The firm received 133 completed questionnaires.

Of those responding, 83% said diversification and potential return was the reason to invest abroad. Only half, however, now invest overseas.

Of those investing internationally, 45% use one international manager; 26%, have hired two firms; and 10% use three advisers.

Also, 40% of the respondents used a core strategy and 42% hedge their currency positions.

—Chuck Paustian

COURTS

Supreme Court asked to review excise tax case

■ The trustees for the estate of Mansfield Tire and Rubber Co. have asked the U.S. Supreme Court to review a case that could affect the treatment of pension excise tax claims in bankruptcy cases.

Attorneys for the trustees are challenging the priority status granted to pension excise tax penalties imposed by the Internal Revenue Service. They believe unsecured creditors are entitled to a greater share of a bankrupt company's estate.

Such excise taxes often are imposed on bankrupt companies that fail to meet their pension obligations, said H. Jeffrey Schwartz, a partner with the law firm of Benesch, Friedlander, Coplan & Aronoff, Cleveland, which represents trustees of the Mansfield estate.

Mansfield Tire, Mansfield, Ohio, failed to meet its minimum pension contributions from 1976 to 1979. The IRS subsequently hit the company with excise tax penalties of 5% to 10% of the amounts due; the agency filed a priority claim in Mansfield's bankruptcy case of \$363,111.20.

While the bankruptcy court and a federal district court ruled the excise tax claims did not deserve priority over the claims of other creditors, the 6th U.S. Circuit Court of Appeals overturned those rulings.

The IRS declined to comment on the litigation.

—Joel Chernoff

COMPENSATION

Report scrutinizes executives' pay

■ Time Warner's Steven Ross and N.J. Nicholas, ITT's Rand Araskog, IBM's John Akers, Dial's John Teets, Champion International's Andrew Sigler and American Express' James D. Robinson III were awarded the dubious honor of "black hats" in terms of executive compensation by the Council of Institutional Investors.

The characterizations were by Graef S. Crystal, adjunct professor at the University of California, Berkeley, and editor of "The Crystal Report on Executive Compensation," based on his own analysis of what top executives of the 500 largest U.S. companies should be paid.

Executives of the largest of the 500 companies with pay that was most out of line with performance were categorized as 1991's black

hats. Another 12 companies had "white hat" top executives, with very modest pay relative to performance.

In the whole universe of companies, less than 5% of pay differentials were attributable to performance, in terms of total shareholder return over 10 different time periods from one year to 10 years.

Institutional investors increasingly have been focusing on executive compensation in shareholder activism campaigns. Several companies have responded to the pressure. ITT announced it would change its compensation structure and American Express cut its CEO's compensation in 1990 in response to a downturn in corporate performance.

—Marlene Givant Star

ACTUARIES

Hewitt found not liable for damages

■ Hewitt Associates is not liable for fiduciary damages as actuary for the Kaiser Steel Retirement Plan, a federal appeals court has ruled.

Kaiser Steel Corp., Colorado Springs, Colo., which had hired Hewitt, Lincolnshire, Ill., to perform actuarial work for its salary retirement plan, restructured its operations in 1980, virtually eliminating its steel-making operations. A resulting surge in early retirees significantly increased the plan's costs. Plans do not advance fund early retirement benefits because they are viewed as contingent liabilities.

But Hewitt did not change the actuarial assumptions for the Kaiser plan. Rather, the responsibility for setting assumptions had been delegated to Kaiser.

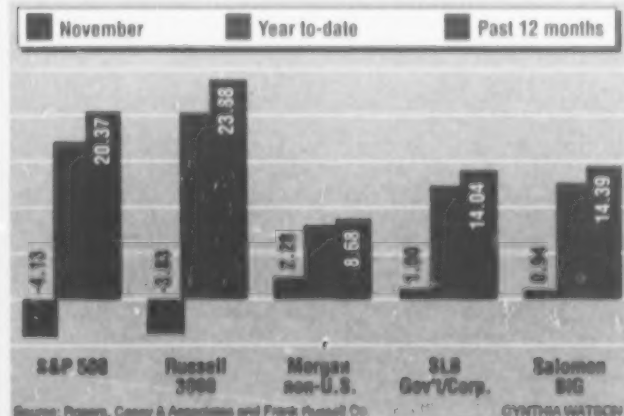
In February 1987, the plan — with \$27 million in liabilities and no assets — was terminated by the Pension Benefit Guaranty Corp. Participants' early retirement benefits, which are not guaranteed by the agency, were wiped out. In one case, a worker's monthly pension check was reduced to \$521 from \$2,016.

Upholding a federal district court, the 9th U.S. Circuit Court of Appeals in Pasadena, Calif., ruled Hewitt, as a service provider, was not a fiduciary to the plan, and that only the Secretary of Labor — not plan participants — can bring actions against non-fiduciaries. The case was remanded to a lower court to consider a state law claim of professional negligence against Hewitt.

—Joel Chernoff

Pensions & Investments' indexes

The P&I monthly indexes track changes in the Standard & Poor's 500 Stock Index, Frank Russell Co.'s Russell 3000 Stock Index, the J.P. Morgan non-U.S. Government Bond Index, the Shearson Lehman Brothers Government/Corporate Bond Index and the Salomon Brothers Broad Investment Grade Bond Index.



Trends in actuarial assumptions

(1986-1990)

